IN THE

Supreme Court of the United States

OCTOBER TERM, 1944

No. 681

WESTERN MESA OIL CORPORATION and EL SEGUNDO OIL COMPANY,

Petitioners,

vs.

EDLOU COMPANY, *et al.*, Landowners in El Segundo Community Lease No. Four-A; EDLOU COMPANY, *et al.*, Landowners in El Segundo Community Lease No. Two-B; A. A. McCRAY, Trustee for holders of overriding royalties in El Segundo Community Lease No. Four-A; A. A. McCRAY, Trustee for holders of overriding royalties in El Segundo Community Lease No. Two-B; A. A. McCRAY, WM. H. RAMSAUR and F. R. C. FENTON,

Respondents.

Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit and Brief in Support Thereof.

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Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

Western Mesa Oil Corporation and El Segundo Oil Company pray that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Ninth Circuit entered in this case.

Opinion Below.

The opinion of the Circuit Court of Appeals for the Ninth Circuit is reported in 143 F. (2d) 843.

Jurisdiction.

The judgment of the Circuit Court of Appeals on petition for rehearing was entered on August 8, 1944 [R. 262]. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

Question Involved.

Is not the permissive authority which is derived from Section 357(1) of the Bankruptcy Act to divide creditors into classes and to treat them in different ways and upon different terms, restricted and limited by Section 366(3) of the Bankruptcy Act which requires as a condition to confirmation of an arrangement that the Court be satisfied that the arrangement is fair and equitable?

Statutes Involved.

The statutes involved may be found in the Appendix, *infra,* pp. 19 and 20.

Statement.

Briefly stated, the facts herein pertinent are as follows:

Sovereign Oil Corporation filed a petition for relief under the provisions of Chapter XI of the Bankruptcy Act. (11 U. S. C. A. Sec. 701 *et seq.* [R. 2].) Among its creditors were the holders of landowners' royalties who had claims for unpaid royalties or rentals on three wells

owned by the debtor, to-wit: Sovereign Wells No. 1, No. 2 and No. 4 [R. 158, 159].

The leases governing all three of these wells contained the customary provisions to the effect that forfeiture for nonpayment of royalties could be effected only after the lessee had failed to rectify the default within the ninety days from the giving of a written notice by the landowner to the lessee [R. 164, 165].

The debtor filed a revised plan of arrangement which included the following provisions:

> "Landowners' royalties which carry with them the right of forfeiture of the oil and gas leases under which such royalties are payable and where such right of forfeiture has not, prior to the filing of the petition in bankruptcy, been waived either in writing or by the conduct of the parties, will be paid in full in the same manner as priority claims. Where, however, the facts disclose that prior to the filing of the proceedings hereunder by the debtor, the landowners, by writing or by their conduct, have legally waived the right of forfeiture as to any of the unpaid royalties, the same will be treated the same as those in the class of unsecured creditors. Should any controversy arise as to the proper status of such claims of holders of landowners' royalties, the same shall be determined by the above entitled Court in the above entitled proceeding upon hearing after notice." [R. 81.]

The revised plan provided for the payment of unsecured creditors by the issuance of the capital stock of a new corporation on the basis of 20% of the amount of their claims [R. 82].

The revised plan further provided that:

> "* * * if there appear to be any objectionable claims filed, the debtor, or any party in interest, including the new corporation, shall have the right to object to the allowance of the same, and such alleged creditors shall participate in the plan as confirmed, only on the basis of the amount of their claims as may finally be allowed by this Court". [R. 84.]

The debtor, its receiver and Western Mesa Oil Corporation filed a petition for the determination of the status of the holders of the landowners' royalties [R. 51].

At the hearing before the referee in bankruptcy, the petitioners urged that (1) the landowners had not acquired the right of forfeiture because of their failure to give the required notices of default [R. 160, 161], (2) the right to declare a forfeiture had been lost because of the acceptance by respondents of royalties from the receiver [R. 189-191] and (3) the filing of unsecured claims in the bankruptcy proceedings by respondents had the effect of constituting a waiver of any right to claim priority [R. 198].

The referee determined the issues on the theory that the language of the revised plan which provided for full payment of landowners' royalties "which carry with them the right of forfeiture" constituted an agreement by the debtor to pay royalties in full where the leases contained foreclosure provisions [R. 72]. This was also the view taken by the District Court and the Circuit Court of Appeals [R. 131, 251]. The petitioners contended that the phrase "carry with them the right of forfeiture" can only mean a right of forfeiture perfected by the giving of the

notice required by the leases in order to give rise to the right to declare a forfeiture. The interpretation given to the plan of arrangement by the lower courts not only is inconsistent with the purposes and spirit of the plan of arrangement evidenced in the reading of such document as a whole, but the interpretation of the lower courts causes the plan to violate Section 366(3) of the Bankruptcy Act (11 U. S. C. A. Sec. 766(3)) which makes it mandatory that a plan of arrangement be "fair and equitable".

Specifications of Errors to Be Urged.

The Circuit Court of Appeals for the Ninth Circuit erred in adopting a construction of a plan of arrangement which creates an inequity between classes of unsecured creditors who are of equal standing, thus violating the requirements of Section 366(3) of the Bankruptcy Act that a plan of arrangement must be fair and equitable.

Reasons for Granting the Writ.

The decision of the Circuit Court that a plan of arrangement may provide for the treatment of unsecured creditors by classification on *any terms even though discriminatory,* is in conflict with the decision of the Circuit Court of Appeals for the Second Circuit in the case of *Lane v. Haytian Corporation of America,* 117 F. (2d) 216, 220, and with the decision of the Circuit Court of Appeals for the Seventh Circuit in the case of *In Re Palisades-on-the Desplaines,* 89 F. (2d) 214 (decided under former Section 77b).

The decision below is also contrary to the principles expressed by this Honorable Court in *American United Mutual Life Insurance Co. v. City of Avon Park,* 311 U. S. 138, 61 S. Ct. 157, 85 L. Ed. 91.

The court below failed to give effect to Section 366(3) of the Bankruptcy Act in construing Sections 306, 351, 356 and 357 of the Bankruptcy Act (11 U. S. C. A. 706, 751, 756 and 757) as authorizing discriminatory treatment between classes of unsecured creditors irrespective of fairness and equity.

The legislative background of Section 357(1) was ignored by the court below. Its legislative sponsors commented that such section was subject to "the inherent restriction that the classification must be upon a reasonable basis and the express provision that the court must approve the plan as fair and equitable". (*Analysis of H. R. 12889, 74th Cong. 2d Sess. (1936) 42* (H. R. 12889 is the forerunner of the Chandler Act of 1938 now in effect).)

If the principle announced by the court below is generally followed, the essential principle and philosophy fundamentally underlying bankruptcy law, to-wit: "equity is equality" would be aborted.

This Honorable Court should review the decision so as to eliminate confusion arising from the conflict of decisions created by the court below, and avert the economic losses that will result from discriminatory plans of arrangements being confirmed on the authority of the decision of the instant case.

Conclusion.

It is, therefore, respectfully submitted that this petition should be granted.

October, 1944.

Respectfully submitted,

RAPHAEL DECHTER,
Attorney for Petitioner.

HARRY A. PINES,
Of Counsel.

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Respondents.

BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI.

Opinion Below.
Jurisdiction.
Question Involved.
Statement of Case.

The essential facts relative to the foregoing matters are stated in the accompanying petition for Writ of Certiorari, and in the interests of brevity are not repeated herein.

Specification of Errors.

The Circuit Court of Appeals erred:

(1) In holding that the plan of arrangement could provide for the payment in full for one class of unsecured creditors, and the payment of 20 cents on the dollar to other classes of unsecured creditors, there being no legal reason or ground for such discrimination.

(2) In interpreting a plan of arrangement as calling for a discriminatory treatment between classes of creditors, the said arrangement being capable of interpretation avoiding such discrimination and unfairness.

(3) In holding that the debtor under a plan of arrangement can bar the right of the receiver and other creditors to object to the unfair and inequitable preference of one class of unsecured creditors over another.

Argument and Authorities in Support of Petition for Writ of Certiorari.

The debtor's revised plan of arrangement provided:

> "Landowners' royalties which carry with them the right of forfeiture of the oil and gas leases under which such royalties are payable and where such right of forfeiture has not, prior to the filing of the petition in bankruptcy, been waived either in writing or by the conduct of the parties, will be paid in full in the same manner as priority claims. Where, however, the facts disclose that prior to the filing of the proceedings hereunder by the debtor, the landowners, by writing or by their conduct, have legally waived the right of forfeiture as to any of the unpaid royalties, the same will be treated the same as those in the class of unsecured creditors. Should any contro-

> versy arise as to the proper status of such claims of holders of landowners' royalties, the same shall be determined by the above entitled Court in the above entitled proceeding upon hearing after notice." [R. 81.]

It is necessary to understand that the law of the State of California offers a landowner no lien or other priority for a claim of rent or royalty. It was conceded in the proceedings below that respondents, under the law, occupied no position superior to that of other unsecured creditors in the bankruptcy estate. It was only in the event that respondents had exercised the right of forfeiture in the oil leases whereunder their claims accrued, that respondents could have enjoyed a position of superiority over the other unsecured creditors of the estate. Had they exercised their right of forfeiture, then they might have been in a position to demand payment in full as a condition to the reinstatement of the leases. It was for this reason, then, that the debtor in proposing a plan of arrangement provided for the payment in full of the claims of royalty holders "which carry with them the right of forfeiture." There was no extraneous evidence to aid the lower court in interpreting the provision of the plan of arrangement with respect to the payment of the claims of the holders of landowners' royalties. The only logical interpretation of the language used in the plan of arrangement was that contended for by the petitioners, to-wit, that payment in full be limited to those landowners whose claims carried the right of forfeiture or, in other words, who had exercised the right of forfeiture by the giving of such notices as were required under the leases. It was

conceded below that the right of forfeiture had not been exercised by the respondents [R. 254]. Despite the fact that this is the only reasonable construction of the language used, there being no reason or right whereby the debtor could prefer the landowners if they had not exercised or perfected their right of forfeiture, the Bankruptcy Court, affirmed by the Circuit Court below, adopted a construction of the provision entirely at odds with the intent and purposes of the plan of arrangement. The Circuit Court of Appeals construed the language to refer to the claims of landowners whose leases included provisions for forfeiture in the event of non-payment of royalties. The mere existence of the forfeiture clause would not serve to enlarge the rights of respondents. The exercise of the right of forfeiture might have such effect. This Court may not be concerned with the error of the lower courts in construing language in a manner unsupported by the evidence. This Court is concerned, however, with the fact that in its erroneous conclusion the Honorable Circuit Court of Appeals modified a plan of arrangement which was otherwise "fair and equitable" into a plan that was neither fair nor equitable, and in direct violation of the provisions of the Bankruptcy Act relating to plans of arrangement. In doing this. the Circuit Court of Appeals held that a plan of arrangement may provide for the division of creditors into separate classes, and for the treatment of such classes on different terms and in different ways. The Circuit Court said: "Appellants' contention that such an arrangement is invalid because giving a priority to one class of unsecured claims over another is without merit." [R. 253.] The Circuit Court relied upon certain sections of the Bankruptcy Act of

1938, to-wit: Sections 306, 351, 356 and 357 of said Act. (11 U. S. C. A. 706, 751, 756 and 757.) This decision which fails to take into regard the limitation of Section 366(3) of the Bankruptcy Act of 1938, results in a dangerous departure from the inherent equitable principles underlying bankruptcy law, and gives approval to plans of arrangement which are essentially discriminatory and inequitable. The Circuit Court failed to give effect to the entire Bankruptcy Act, particularly all of Chapter XI relating to arrangements. Had it given effect to all of Chapter XI, the Circuit Court would have been compelled to limit Section 357 of the Bankruptcy Act by Section 366(3) of said Act, which makes it mandatory that a plan of arrangement be "fair and equitable." The law does not permit discriminations. The Bankruptcy Act permits the treatment of separate classes of creditors in different ways and upon different terms, provided that classes of equal standing are treated in parity with each other, and provided further that the result thereof is fair and equitable.

The Circuit Court below ignored the historical development of Chapter XI of the Bankruptcy Act relating to arrangements. Section 357(1) which provides for the division of creditors into classes and the treatment of such classes in different ways and upon different terms was not intended to be an isolated blanket authority, divorced from the remaining restrictions and provisions in Chapter XI. The sponsors of Section 357(1) commented that such section was subject to "the inherent restriction that the classification must be upon a reasonable basis and the express provision that the court must approve the plan as

fair and equitable." *Analysis of H. R. 12889, 74th Cong., 2d Sess. (1936) 42.* (H. R. 12889 is the forerunner of the Bankruptcy Act.)

The requirement of Section 366(3) that the plan be fair and equitable essentially contemplates that there be no unfair discrimination between classes of creditors. This is evident from the *Analysis of H. R. 12889, 74th Cong., 2d Sess. (1936),* p. 78, with respect to the meaning of "fair and equitable" as applied to plans of reorganization. It is there stated:

> "Derived from 77 B f (1). 'Equitable' would include 'fair,' and would also prevent an unfair discrimination in favor of any class of creditors or stockholders. The provision has been condensed accordingly."

It is obvious, then, that Congress felt that it would merely have been redundant to have expressly stated that a plan of arrangement must avoid unfair discriminations in favor of any class of creditors. The words "fair and equitable" have been held to be "words of art" with well understood meaning. (*Securities & Exchange Commn. v. U. S. Realty & Improvement Co.* (1940), 310 U. S. 434, 60 Sup. Ct. 1044, 84 L. Ed. 1293.) (See particularly the dissenting opinion of Justice Roberts.)

The decision of the Circuit Court of Appeals is in direct conflict with that of the Honorable Circuit Court of Appeals for the Second Circuit in the case of *Lane v. Haytian Corporation of America,* 117 Fed. (2d) 216, 220, which expressly declares that a preference given to one class of creditors over another "violates the principle of parity of treatment required by Section 366(3) * * *."

The decision of the Circuit Court below is also in conflict with that of the Honorable Circuit Court of Appeals for the Seventh Circuit in the case of *In Re Palisades-on-the-Desplaines,* 89 Fed. (2d) 214 (decided under former Section 77-B). The decision of the Circuit Court below is in conflict with the principles enunciated by this Honorable Court in the case of *American United Mutual Life Insurance Co. v. City of Avon Park* (1940), 311 U. S. 138, 61 S. Ct. 157, 85 L. Ed. 91, in which this Court said:

> " 'Beyond that is the question of unfair discrimination to which we have adverted. Compositions under chap. IX, like compositions under the old Sec. 12, envisage equality of treatment of creditors. Under that section and its antecedents, a composition would not be confirmed where one creditor was obtaining some special favor or inducement not accorded the others, whether that consideration moved from the debtor or from another. Re Sawyer (DC) 2 Low. Dec. 475, Fed. Cas. No. 12,395; Re Weintrob (DC) 240 F. 532, 39 Am. Bnkr. Rep. 407; Re M. & H. Gordon (DC) 245 F. 905, 40 Am. Bankr. Rep. 301. As stated by Judge Lowell in Re Sawyer, *supra,* "If a vote is influenced by the expectation of advantage, though without any positive promise, it cannot be considered an honest and unbiased vote." That rule of compositions is but part of the general rule of "equality between creditors" (Clarke v. Rogers, 228 U. S. 534, 548, 57 L. ed. 953, 959 S. Ct. 587, 30 Am. Bankr. Rep. 39) applicable in all bankruptcy proceedings. That principle has been imbedded by Congress in chap. IX by the express provision against unfair discrimination.' "

By giving effect to Section 357(1) of the Bankruptcy Act without regard to its qualification by Section 366(3) of the Bankruptcy Act, the Circuit Court below ignored elementary principles in the construction of statutes, that every section, provision and clause shall be expounded by a reference to every other; that every clause and provision shall have the effect contemplated by the legislature; that one portion should not be construed to annul or destroy what has been clearly granted in another; and that all sections, paragraphs and clauses, if possible, shall be so construed that all may stand together.

Peck v. Jenness, 7 How., 48 U. S. 612, 12 L. Ed. 841;

Colby v. Ledden, 7 How., 48 U. S. 626, 12 L. Ed. 847;

Ginsberg v. Popkin, 285 U. S. 204, 76 L. Ed. 704, 52 S. Ct. 322.

The decision of the court below infers that the creditors participating under the plan of arrangement were bound to a construction of the plan of arrangement as interpreted by the court below resulting from a purported ambiguity created by the debtor. Were there such an estoppel, it would not serve to have estopped the creditors of this estate represented by the receiver and the new corporation (whose stockholders consisted of the unsecured creditors) from asserting the unfairness and inequity of the revised plan of arrangement as construed by the court

below. The receiver and the new company, in behalf of the creditors thus discriminated against, opposed the discrimination. It would appear also that the court *sua sponte* would have acted to avert the discriminatory effect of the payment of 100¢ on the dollar to one class of creditors who enjoy no greater legal rights than those of other classes of creditors who were paid only 20¢ on the dollar in the form of stock of a new corporation. Appellant Western Mesa Oil Corporation is the corporation which immediately took over the assets of the debtor company for the purpose of facilitating the transfer to the new corporation, and appellant El Segundo Oil Company is the new corporation whose stock was issued to unsecured creditors and who took over the assets from Western Mesa Oil Corporation. Appellants, therefore, are the unsecured creditors who were discriminated against by this plan of arrangement.

It should be apparent that the decision of the Circuit Court of Appeals below is such that, if permitted to stand, it will create inestimable confusion and havoc in the administration of Chapter XI proceedings. It is of utmost importance that this court take jurisdiction by certiorari and resolve the conflict of opinion existing between the decision of the Circuit Court of Appeals for the Ninth Circuit and the other Circuits. Chapter XI, a part of the Chandler Act of 1938, is still in its early stages of operation. There is still much confusion with respect to its provisions. The decision of the Ninth Circuit in this case

adds immeasurably to that confusion. The holding that a plan of arrangement may treat equal classes on different terms and discriminatorily is a dangerous precedent, and one which may be the instrument of great injustice. We respectfully urge that this petition should be granted.

Respectfully submitted,

RAPHAEL DECHTER,
Attorney for Petitioner.

HARRY A. PINES,
Of Counsel.

APPENDIX.

"Sec. 306. For the purposes of this chapter, unless inconsistent with the context—

"(1) 'arrangement' shall mean any plan of a debtor for the settlement, satisfaction, or extension of the time of payment of his unsecured debts, upon any terms; * * *" (11 U. S. C. A. 706.)

"Sec. 351. For the purposes of the arrangement and its acceptance, the court may fix the division of creditors into classes and, in the event of controversy, the court shall after hearing upon notice summarily determine such controversy." (11 U. S. C. A. 751.)

"Sec. 356. An arrangement within the meaning of this chapter shall include provisions modifying or altering the rights of unsecured creditors generally or of some class of them, upon any terms or for any consideration." (11 U. S. C. A. 756.)

"Sec. 357. An arrangement within the meaning of this chapter may include—

"(1) provisions for treatment of unsecured debts on a parity one with the other, or for the division of such debts into classes and the treatment thereof in different ways or upon different terms; * * *" (11 U. S. C. A. 757.)

"Sec. 366. The court shall confirm an arrangement if satisfied that—

"(1) the provisions of this chapter have been complied with;

"(2) it is for the best interests of the creditors;

"(3) it is fair and equitable and feasible;

"(4) the debtor has not been guilty of any of the acts or failed to perform any of the duties which would be a bar to the discharge of a bankrupt; and

"(5) the proposal and its acceptance are in good faith and have not been made or procured by any means, promises, or acts forbidden by this Act." (11 U. S. C. A. 766.)

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Respondents.

Brief in Opposition to Petitioners' Writ of Application for Certiorari.

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Respondents.

Brief in Opposition to Petitioners' Writ of Application for Certiorari.

The assignment of error raises purely the questions of fact, which were determined adversely to the petitioners below, and which do not require the consideration of this court.

Petitioner asks if the authority given under Section 357 (1) of Chapter IX of the Bankruptcy Act, to divide unsecured debts into classes, is not restricted by Section 366 (3).

Undoubtedly Section 366 (3) requires the Court to examine any plan presented by a debtor and to determine if "it is fair and equitable and feasible" and if the debtor has met the other requirements of this Section. If the Court is satisfied on these points it becomes its duty to confirm the arrangement.

In this case the Bankruptcy Court duly and regularly considered the plan and found "that the revised Plan of Arrangement is fair and equitable and feasible" [Rec. 94-95, Par. 3] and that the other requirements of Section 366 had been complied with. The Court also found that "no objection or opposition to the confirmation of said revised Plan of Arrangement was presented" [Rec. 95]. These are findings of facts.

"The conclusions of the Bankruptcy Court upon the question of facts relating to whether a reorganization plan was unfair, inequitable and discriminatory, when supported by evidence and a large majority of creditors, should not be disturbed" . . . .*Siedell v. Palisades on the Des Plaines,* 89 Fed. (2d) 214, Syl. 8.

Section 366 (3) requires that the Court shall be satisfied not only that the arrangement is fair and equitable but also that it is feasible. The plan presented by the debtor would not have been feasible if the landowners had exercised their right to declare a forfeiture of the leaseholds upon which the oilwells were located, as those wells constituted virtually all of the assets of the debtor [Rec.

10]. (Schedule B . . . 1.) It was solely by reason of the agreement, made by the landowners with the debtors and the unsecured creditors, to consent to the Plan of Arrangement and to withhold any declaration of forfeiture, that any assets were left in the hands of the debtor with which to affect a composition with his creditors.

The question of fact as to whether the respondents had waived their right to declare such a forfeiture, was raised by the Plan of Arrangement [Rec. 81] and the method by which the question was to be determined was likewise set out in the plan in the same paragraph [Rec. 81]. The Referee tried the question and found that the respondents had not waived their right [Rec. 68; Rec. 72] and that respondents were entitled to payment of their claims in full under the terms of the plan. The Referee's judgment was sustained by the District Court upon review and by the Circuit Court of Appeals upon appeal (143 Fed. (2d) 843). Those questions of fact were thoroughly settled.

In their petition for writ of Certiorari to this Court, petitioners apparently abandon the ground upon which they asked for a review in the District Court and upon which they appealed to the Circuit Court, to-wit: the claim that respondents had waived their right to declare a forfeiture of leaseholds for non-payment of royalties and now apparently advance the proposition that it is inherently inequitable and discriminatory to divide unsecured debts into classes and to treat them in different ways and upon different terms. This must be their contention as the question of fact upon which they challenge respondents claims was decided adversely to them by the Referee who was sustained by the District and Circuit Courts.

As Chapter XI deals only with unsecured claims, this is to ask that Chapter XI be stricken from the Bankruptcy Laws. The power of Congress in the field of bankruptcy is both unlimited and supreme. *West Coast Life Insurance Co. v. Merced Irrigation District,* 114 Fed. (2d) at page 673. It is elementary that unsecured claims are of different classes. The General Bankruptcy Law (Section 64), makes such a division as for instance, it provides for claims for wages earned within a certain period before bankruptcy shall be paid in full in priority even to secured claims. Numerous other examples could be cited.

Certainly a lessor of oil land who reserves the right of recovery of land upon non-payment of royalties owns a debt that is different than that of a merchant who sells goods upon an open book account and must rely for recovery upon a personal judgment. None of the cases cited by petitioners support their proposition; all by implication recognize that there are classes of unsecured debts and at most hold only that there should be reasonable grounds for division between the classes.

Wherefore respondents request that the Writ of Certiorari be denied to petitioners.

Respectfully submitted,

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Attorney for Respondents.

BRITTON BOWKER,
H. L. WELCH,
Of counsel.